

FY2010

FEDERAL, STATE AND LOCAL
GOVERNMENTS

WORK PLAN



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FY2010 FSLG Work Plan

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TABLE OF CONTENTS

Topic	Page
Executive Summary	4
Planning Process	
Overview of FSLG	10
Methodology	11
Work Plan Areas	12
BAC 52, PAC TT	13
Customer Education and Outreach	13
Stakeholder Relationship	13
Cross Functional Relationships	15
Other Actions	16
Performance Measures	16
BAC 64, PAC EF	17
Workload Selection	17
Training	17
Compliance Plan	17
Research	18
Performance Measures	19
Appendices	
Appendix A: Training	20
Appendix B: Compliance Plan	22
Appendix C: Research Plan	29

Executive Summary

The Office of Federal, State and Local Governments (FSLG) supports the Internal Revenue Service (IRS) and the Tax Exempt and Government Entities (TE/GE) Division strategic goals:

- 1) Improve service to make voluntary compliance easier; and
- 2) Enforce the law to ensure everyone meets their obligation to pay taxes.

Major trends affecting the IRS: 2009-2013

- 1) Increasing complexity of tax administration
- 2) Growing human capital challenges
- 3) Explosion in volume of electronic data, online interactions, and related security risks
- 4) Accelerating international elements to taxpayer transactions
- 5) Expanding role of tax practitioners and other third parties in the tax system
- 6) Accelerating change in business models

Goal 1: Improve service to make voluntary compliance easier

- Objective 1: Incorporate taxpayer perspectives to improve all service interactions
- Objective 2: Expedite and improve issue resolution across all interactions with taxpayers, making it easier to navigate the IRS
- Objective 3: Provide taxpayers with targeted, timely guidance and outreach
- Objective 4: Strengthen partnerships with tax practitioners, tax preparers, and other third parties in order to ensure effective tax administration

Goal 2: Enforce the law to ensure everyone meets their obligations to pay taxes

- Objective 1: Enforce the law in a timely manner while respecting taxpayer rights and minimizing taxpayer burden
- Objective 2: Expand enforcement approaches and tools
- Objective 3: Meet the challenges of international tax administration
- Objective 4: Allocate compliance resources using a data-driven approach to target existing and emerging high-risk areas
- Objective 5: Continue focused oversight of the tax-exempt sector
- Objective 6: Ensure that all tax practitioners, tax preparers, and other third parties in the tax system adhere to professional standards and follow the law

Strategic Foundations: Invest for high performance

- Objective 1: Make the IRS the best place to work in government
- Objective 2: Build and deploy advanced information technology systems, processes, and tools to improve IRS efficiency and productivity
- Objective 3: Use data and research across the organization to make informed decisions and allocate resources
- Objective 4: Ensure the privacy and security of data and safety and security of employees

In support of these goals, FSLG has committed to the following work plan areas:

- Continue the Federal Agency compliance initiative,
- Continue the Large Entity compliance initiative,
- Participate in the Service wide Employment Tax National Research Project (NRP),
- Initiate international issues and activities,
- Continue work on compliance projects to address various compliance issues of specific market segments within state and local entities,
- Continue to address Abusive Tax Avoidance Transactions (ATATs),
- Increase emphasis on Fraud perpetrated in the government sector,
- Build a highly qualified and satisfied work force,
- Meet customer needs by providing educational activities,
- Encourage voluntary compliance by government entities,
- Improve organizational performance, and
- Improve knowledge and information management.

A central theme in the FY2010 Work Plan is FSLG's focus on continuing to improve its compliance efforts with a balance between service and enforcement. Specifically, FSLG is committed to continuing its Federal Agency initiative and increase cases in the Large Entity compliance initiative. FSLG will continue to conduct compliance projects designed around specific market segments or issues to improve compliance among state and local entities. FSLG will complete analysis of its classification program to improve the case selection process. FSLG will develop additional audit guides and tools to improve the consistency and efficiency of FLSG compliance activities.

FY2009 Accomplishments

In FY2009, FSLG met or exceeded its performance goals related to examination and compliance check closures, hours on cases, and outreach customers reached. FSLG staff members serve on the Enterprise-wide Employment Tax Strategy Team and the Service wide Non-filer Strategy Team. FSLG strengthened its relationship with various stakeholders by developing a presentation at NCSSSA National Training Conference in conjunction with leaders of NCSSSA and SSA. In addition, SSA and FSLG representatives continue to meet regularly to discuss issues and work on educational materials of joint interest.

FSLG was successful in dramatically reducing average cycle time of examination cases from 303 days at the end of FY2008 to 260 days at the end of FY2009.

During FY2009, Surveys of FSLG taxpayers, whose examinations closed during the first six months in FY2009, indicate an overall satisfaction of 69%. This is an increase of 6% from the prior six months, April to September 2008. The number dissatisfied decreased from 12% for the period April to September 2008 to 6% for the period October 2008 to March 2009. The taxpayers were most satisfied with Courtesy of the Specialist and Knowledge of the Specialist (6.16 and 6.06, respectively on a scale of 1 to 7 with 7 being most satisfied).

During FY2009, FSLG drafted several compliance project reports including: audits of community colleges and housing authorities market segments, compliance checks of the fire district market segment as well as projects on potential Form 1099-MISC non-filers and compliance with closing agreements.

During FY2009, FSLG's Group of Nine Program completed several important projects. The Group of Nine concept creates limited-term teams of employees from different FSLG groups, serving as an advisory group to the FSLG Director on any topics related to the operations of FSLG, including technical issues, personnel, operational, communications, and skills transfer, identifying what we do well and need to keep doing, and what needs improvement. During FY2009, one Group of Nine helped to identify topics for FSLG's 2009 CPE, another initiated and completed an ET tax spreadsheet that permits input of taxpayer data one time to generate a complete Revenue Agent Report, and another began to develop a comprehensive classification audit guide.

During FY2009, FSLG completed an Information Return Audit Guide that provides a comprehensive one source resource for information return examinations, including reference material, IDRs, etc.

During FY2009, FSLG in coordination with EO created a web-based course called "Implications of International Tax Law on TE/GE-Web Based Learning

Development Project” (course included international issues, primarily related to EO status and employment tax issues).

During FY2009, FSLG participated in the All Island Tax Administrators Association (AITAA) meetings. These meetings give FSLG an understanding of the financial condition of each of the Territories and introduce FSLG and its goals to the Revenue Commissioners of the Territories. An FSLG staff member was added to the 2009 Authorization List, which gives FSLG the authority to request information directly from U.S. Territories. Examples of this information would include current listings of identified state and local government entities and information return filings.

Strategic Initiatives

In FY2005, FSLG committed to addressing compliance by Federal agencies with Federal tax laws. The compliance plan included the formation of a dedicated Federal Agency compliance group in September, 2005. In FY2009, the Federal Agency compliance group opened 15 examinations and completed examinations of 15 Federal agencies. In FY2010, FSLG anticipates opening 15 and closing 15 examinations of Federal agencies or sub-agencies. FSLG will also continue to work with Collection and the CFO's office to coordinate resolution of employment tax delinquencies by Federal agencies. It will work to address various international tax compliance issues within Federal agencies.

In FY2005, FSLG also committed to implementing a compliance program that addresses large non-Federal government taxpayers. Historically, these taxpayers, with annual payrolls in excess of \$40 million, have generally not been examined and are large enough to have significant impact on the Social Security and Medicare trust funds. These taxpayers employ over 80% of all non-Federal government employees. In FY2009, FSLG opened examinations of 30 large non-Federal entities and closed 35. In FY2010, FSLG will increase resource devoted to this initiative, opening 45 and closing 45 examinations of large entities.

Abusive Tax Avoidance Transactions

FSLG supports the IRS wide effort to identify and eliminate ATATs. It will continue with its efforts to identify customer participation in abusive schemes. The FSLG customer base is primarily tax-neutral enablers of some schemes. Its efforts will include developing information for use in educational programs as well as providing guidance to its compliance personnel.

Fraud

Additional emphasis to the fraud process and the development of indicators of fraud are being communicated to FSLG specialists in conducting their

examinations. While fraud is not usually perpetrated by a government entity, fraud may be uncovered in transactions with taxpayers related to the government entity. Guidance is being issued and the FSLG Internal Revenue Manual is being updated with procedures and case scenarios, and training is being conducted instructing specialists to be alert to indicators of fraud, and pursuing areas that may be outside of the traditional employment tax audit if information received indicates possible fraudulent intent. Specialists are working corporately by referring potential fraud to other divisions and following up on the referrals to ensure that taxpayers outside the FSLG customer base are pursued.

Special Projects

During FY2009, FSLG drafted several market segment compliance project reports which involved audits of Community Colleges and Housing Authorities and compliance checks of Fire Districts. In addition, it drafted reports on a Form 1099-MISC non-filer compliance check project and a project to check compliance with classification settlement program (CSP) and other closing agreements. It completed an analysis of results of examinations and compliance checks conducted in 2006, 2007 and 2008. FSLG will use these reports to conduct focused outreach to market segments based upon the most common areas of non-compliance. This effort may include publishing articles in the FSLG Newsletter, seeking opportunities to publish articles in other industry journals, conducting a phone forum, etc. We will use the results to enhance case selection.

In FY2010 through 2012, FSLG will devote a significant amount of its examination resources to the Employment Tax National Research Program (ETNRP). ETNRP is a three-year project designed to develop data to help identify sources of the tax gap related to employment taxes. The project was developed during FY2009 as part of an IRS-wide effort. FSLG has committed to examine 360 returns or 90 entities during FY2010. These audits are expected to begin in January 2010. The number of examinations conducted in FY2011 and 2012 is expected to increase based upon experience and available resources. Due to the potential impact of these cases, some of which are large agency cases, FSLG will limit other projects to small compliance projects in FY2010.

In FY2010, FSLG will begin development of an international compliance program. This program will include outreach activities, as well as examinations of 25 employment tax returns related to international issues including Form 1042 audits of colleges/universities, Form 1042 nonfilers, organizations that have filed significant numbers of Forms 1042-S but have stopped filing Forms 1042-S, organizations not properly complying with employment taxes based upon visa or resident alien status, and compliance activities in the U.S. Possessions.

FSLG is coordinating with TE/GE's Exempt Organization (EO) business unit on a compliance project for colleges and universities, which is focusing on unrelated

business taxes, employment taxes and inurement/private benefit issues. This project involved sending a compliance check questionnaire to 400 randomly selected public and private colleges and universities. EO will conduct 38 examinations that will open at the beginning of FY 2010. FSLG will conduct employment tax examinations of public universities selected for the EO college and university project.

Emerging Issue

Many Federal agencies hire workers via personal service contracts (PSC), which are currently treated by most Federal agencies as independent contractors. However, many of the workers are employees under common-law rules. In FY2009, FSLG coordinated with TE/GE Counsel and Office of Personnel Management to develop consensus related to this issue. FLSG began to address worker classification noncompliance related to PSC during its FY2009 outreach activities. It will continue these outreach efforts in early FY2010. It will begin to conduct compliance checks during FY2010 to specifically address whether the agencies have PSC language that directs how the workers are to be treated for employment tax purposes and the agencies' understanding of and plans to comply on the issue. In FY2011, FSLG will initiate examinations to enforce compliance.

Outreach

FSLG will continue to address key areas of noncompliance through a combination of targeted outreach, development of new educational products, and various field compliance activities. While focus will be placed on the national and regional issues identified through research, environmental scanning, and other means, activities to address significant local issues will also be supported.

One of the primary areas of outreach and education will be section 3402(t) of the Code that requires 3 percent withholding by certain government entities on any payments made to any person providing property or services.

In FY2010, FSLG will begin a new 218 Agreement Outreach Project. It will work with NCSSSA to develop enhanced 218 Agreement scenarios or case studies to be used in outreach. FSLG will work with State Social Security Administrators to assess the need for expanded 218 Agreement Outreach across the country.

In FY2010, FSLG will collaborate with Employee Plans to develop outreach and education specific to the GE customer base to assist them in understanding and complying with their EP responsibilities as well as the employment tax ramifications related to plan issues. This includes delivery of outreach/education and the development of tools to assist entities with their compliance responsibilities.

Planning Process

OVERVIEW OF FSLG

The office of Federal, State and Local Governments is responsible for Federal tax administration issues relating to over 105,000 government entity employer identification numbers. FSLG's primary objective is compliance of governmental units and their subordinate agencies in the United States with employment taxes and information reporting. FSLG is also responsible for ensuring compliance with, and assisting in, the administration of FICA coverage agreements under the provisions of Section 218 of the Social Security Act.

In FY2010, FSLG will continue to maintain an effective balance between traditional compliance work and educational activities. Compliance activities will be a major focus for all field groups.

FSLG continues to develop an annual comprehensive compliance plan involving managers, field Specialists and CPM staff. This compliance plan is incorporated into the FSLG Annual Work Plan. Responsibility for the development of the Annual Work Plan is vested with the Manager, Compliance and Program Management.

FSLG's interaction with its customer base affects the degree of compliance by the governmental employers and their 23 million employees. These entities employ approximately 20% of the American workforce, pay wages in excess of \$775 billion annually and pay employment taxes in excess of \$200 billion. Governments also purchase goods and services of more than \$2.9 trillion, which represents 19% of the United States gross domestic product, and have assets in excess of \$16 trillion.

At the start of FY2010, FSLG will have 87 field Specialists, including 9 FSLG Specialists assigned to the Federal Agency Group. In FY2010, FSLG anticipates losing one employee to retirement at the end of the first quarter and two more at the end of the second quarter. Approximately 20 percent of FSLG Specialists are eligible to retire in FY2010.

METHODOLOGY

Trends, Issues, and Problems (TIPs) were identified in the Strategic Business Plan for FY2010 at the time of its formulation. The FSLG office involved the field Specialists, managers, and CPM staff in the development of the work plan.

The foundation for the formulation of the FY2010 FSLG Work Plan is based on the TIP areas, but refined to specific issues through the analysis of IRS data, stakeholder input, and employee input. These issues form the basis for the compliance activities to be undertaken in FY2010. The major areas of emphasis are: examinations, compliance checks, and information reporting compliance.

The employment tax field in general and the governmental sector in particular, have not been the subject of significant research activity or information gathering at the Service level. Governments generally file only employment tax and information returns. There are no additional returns to provide compliance indicators, thus classification avenues are limited. An additional complicating factor is the ability of governments to file “consolidated” employment tax returns, a process unavailable to any other group of employers in the country.

This lack of basic information has been considered in developing the FSLG compliance workload selection process. FSLG has considered anecdotal evidence, customer contact data, results from past compliance contacts, and employee input in developing its examination plans for FY2008-2010. It is continually improving the process. To accomplish this, FSLG:

- developed a formal workload selection plan to ensure consistency and impartiality in its examination process;
- established state folders that include state specific information (section 218 agreement, qualified retirement plan, section 403(b) plan, etc.). These are useful tools in workload selection;
- included workload selection and risk analysis in its FY2008-2010 Research Plan;
- will conduct a portion of its examinations based on market segments and compliance projects to determine compliance levels and identify significant issues in those segments; and
- will continue to analyze the data collected from closed compliance checks and examinations and utilize the data in workload selection and in conducting future outreach activities.

WORK PLAN AREAS

FSLG will support the TE/GE Division major strategies and operating priorities for FY2010. These strategies address key challenges FSLG faces in delivering top quality service to customers, and productivity through a quality work environment. These include actions to:

- **Improve Compliance:** FSLG will continue to utilize employee input, customer feedback, data analysis, and environmental scanning, to secure a comprehensive knowledge of key compliance issues and causes of noncompliance. The information obtained from these and other sources will be used to improve compliance within its customer base.
- **Meet Customer Needs:** FSLG will work closely with stakeholders, partners, and the Advisory Committee on Tax-exempt and Government Entities (ACT) to ascertain FSLG customer's needs, as well as to design and deliver mutually agreeable remedies to identified compliance concerns and problems whenever possible. In addition, the FSLG Newsletter and educational products will be used to address compliance questions and issues.
- **Improve Organizational Performance:** FSLG will utilize balanced measures and analyze the results to effect operational enhancements to improve performance.
- **Improve Knowledge and Information Management:** FSLG will expand its gathering and use of data, and fully develop database tools to improve its abilities to identify, track, and measure the impact of all field activities. It will continue to support the development and implementation of TREES as the TE/GE work-center.
- **Continue to address Federal Agency Compliance:** FSLG will continue examinations of Federal agencies during FY2010.
- **Continue the Large Entity Compliance Initiative:** FSLG will continue examinations of larger entities during FY2010.
- **Address Abusive Tax Avoidance Transactions:** FSLG will continue to work on cases involving abusive health reimbursement arrangements and coordinate with Chief Counsel and Area Counsel. In addition, FSLG will incorporate steps to identify customer participation in abusive schemes. Its efforts will include developing information for use in educational programs as well as providing guidance to its compliance personnel.
- **Build a Highly Qualified and Satisfied Work Force** FSLG will continue to train its workforce to ensure that employees have the skills necessary to meet customer needs. It will continue its use of the employee survey to identify opportunities for improvements in employee satisfaction. It will continue to involve managers and employees in improvement processes for FSLG, such as with the Group of Nine and development of audit guides and tools.

BUDGET ACTIVITY CODE 52, PAC TT

These codes correspond to the resources devoted to Pre-filing Education and Assistance, which includes customer education and outreach, direct and indirect assistance, and coordination of assistance actions between FSLG and other functions.

Customer Education and Outreach

FSLG continues to address key areas of noncompliance through a combination of targeted outreach, development of new educational products, and various field compliance activities.

FSLG recognizes the potential positive impact on taxpayer compliance resulting from providing customer education and outreach. Therefore, as it seeks new outreach partnering opportunities, FSLG is working to expand the use of phone forums to reach large numbers of taxpayers. For example, it will conduct phone forums for community colleges, fire districts, and housing authorities to share findings of market segment compliance projects and to discuss areas of non-compliance in those market segments.

FSLG will continue to publish its semiannual newsletter. The FSLG Newsletter serves as a useful means for providing information on current issues, such as tax law changes, ATATs, and new published guidance. There are currently almost 33,000 subscribers.

Stakeholder Relationship

Social Security Administration

FSLG will continue to partner with the Social Security Administration (SSA) as a major external stakeholder while maintaining and increasing partnership activities with other stakeholders. In FY2007, FSLG worked with SSA to develop procedures for its employees to contact designated officials at SSA with regard to the interpretation of Section 218 Agreements during an examination. FSLG continues to monitor this process and implement improvements when necessary. This partnership with SSA will enhance its relationship with an important partner in addition to improving cycle time on examinations. FSLG continues to partner with SSA in the development of important legal questions. During FY2008, FSLG and SSA developed a compliance tool entitled "Section 218 Questions for use by SSA coverage specialists" to assist both FSLG Specialists and SSA Regional Coverage Specialists.

National Conference of State Social Security Administrators

The National Conference of State Social Security Administrators (NCSSSA) is an organization with which FSLG partners regularly in providing education and outreach to government entities. Additionally, FSLG Specialists contact the State Social Security Administrator (SSSA) for the specific State if assistance with Section 218 Agreements and other State specific issues is needed. In FY2008, NCSSSA was invited to speak at FSLG's annual continuing professional education meeting. As a result, many steps to improve the relationship between the SSSAs and FSLG have been taken by NCSSSA and FSLG. In FY2010, FSLG will work with NCSSSA to develop 218 Agreement scenarios or case studies that will be used for both internal and external training. FSLG Specialists will be encouraged to partner with the appropriate SSSA when conducting outreach events.

Advisory Committee on Tax-Exempt Government Entities

The Advisory Committee on Tax-Exempt Government Entities (ACT) includes three members who represent government entities and work on project related to FSLG issues. The ACT makes recommendation that improve compliance by government entities. For example, in FY2006, as recommended by the ACT, FSLG created a Public Employer Toolkit on it website to assist government entities in meeting their tax obligations and in FY2007, the ACT made recommendations with regard to Forms 1042. A number of enhancements have been made to the Toolkit since it was originally created. In FY2010, Director, FSLG will work with the ACT to complete and implement a questionnaire that government entities may use to conduct self-checks. The questionnaire will be added to FSLG's website upon completion.

Section 3402(t)

Section 3402(t) (1) of the Code generally requires the Government of the United States, every state, and every political subdivision and instrumentality of the foregoing, to deduct and withhold 3 percent of payments made to any person for property or services after December 31, 2011. Political subdivisions of a state (or any instrumentality thereof) making payments of less than \$100 million per year for property or services are exempt from this requirement. Proposed regulations published December 5, 2008, contain a per payment threshold of \$10,000 before imposing withholding. The proposed regulations outline several other exceptions. It is expected that the IRS will issue additional guidance with regard to section 3402(t) in FY2010. During FY 2010, FSLG will continue to meet with Federal agencies and State and local governments affected by Section 3402(t) to discuss issues, concerns, comments and suggestions on the provision. FSLG will continue to provide education on the implementation of the proposal. The education and outreach with regard to the application of Section 3402(t) will be a significant part of FSLG's outreach activities in FY2010.

Cross Functional Relationships

Enterprise-wide Employment Tax Strategy Team

In FY2007, the IRS adopted an Enterprise-wide Employment Tax Strategy and created a team consisting of members from each Operating Division in order to ensure consistency in the application of laws regarding Federal employment tax. FSLG, represented by the Director and CPM manager, are active participants on this Team and will continue to do so in FY2010.

Service-wide Nonfiler Strategy Team

In FY2007, the IRS also adopted a Service-wide Nonfiler Strategy and created a team consisting of members from each Operating Division to ensure that each Unit included nonfiler compliance in its work plan. In FY2007 and 2008, FSLG addressed filing compliance through soft notices/self-correction, compliance checks and correspondence examinations. In FY2009, it conducted a specific project dealing with Forms 1099-MISC Nonfilers. In FY2010, FSLG will continue to address filing compliance in all compliance contacts and will continue to identify regional pockets of non-filing by small governments that can be addressed primarily through “soft notices” and self-correction.

LMSB (International)

FSLG is participating with LMSB International on several activities: a cross-functional committee to discuss outreach and education on international issues and determine how requests for outreach should be routed so that appropriate BODs are involved; developing a follow-up compliance plan on federal agencies with overseas workers (based on compliance reviews done 15-20 years ago on certain Federal agencies, wherein IRS determined issues of incorrect worker classification resulting in improper IRC Sec 911 exclusions), and inadequate wage and 1099 reporting. In addition, FSLG will continue an outreach effort to provide education to government entities within the U.S. Possessions. It will conduct 25 examinations of Forms 1042 or other returns with international issues, for example Forms 941 when workers should be treated as resident aliens rather than non-resident aliens.

SB/SE (Collection)

FSLG and SB/SE Collection will continue to work together to resolve Federal Accounts Receivable Dollar Inventory (ARDI) accounts, and coordinate activities to resolve delinquent accounts of state and local governments.

Other Actions

Balanced Measures - FSLG will continue to use balanced measures to determine employee satisfaction, customer satisfaction, and business results. Results of these measures will assist FSLG in ensuring that actions undertaken do not adversely impact any of the three areas, and will assist FSLG in identifying areas in need of operational improvements in subsequent years.

The FSLG measures being used for employee satisfaction and business results are generally consistent with measures used by other functions. FSLG will continue use of the employee survey to identify opportunities for improvements in employee satisfaction. It will continue to involve managers and employees in improvement processes for FSLG. As described below, FSLG will continue to provide training to its workforce to ensure that employees have the skills necessary to meet the visions and goals of FSLG.

The FSLG Customer Satisfaction Survey conducted at outreach events has shown a high degree of customer satisfaction with the content and delivery of its educational programs. FSLG will work to keep the customer satisfaction at current levels during FY2010.

During FY2010, FSLG will work with TE/GE Data Analysis Unit (DAU) to complete a work study. The results of this work study will help FSLG identify where government entities of different sizes are located, identify any areas in which FSLG has conducted a limited number of compliance activities, etc. This study will help FSLG identify future hiring needs as well as other demographic trends that can be used to more efficiently provide services to taxpayers and more effectively address compliance issues.

Performance Measures

The following performance indicators will be used in FY2010 for assessing Budget Activity Code 52, PAC TT activities:

Federal State & Local Governments	FY2010 Plan
Number of Outreach Events	200
Number of Customers Reached	14,200

BUDGET ACTIVITY CODE 64, PAC EF

This area represents the resources devoted to Field Compliance Services, including compliance checks, return examinations, research projects, and related support work.

Workload Selection

FSLG will continue to refine the workload selection criteria utilized in prior years. In addition, FSLG will partner with Exempt Organizations (EO) in situations where the government entity is also an exempt organization (e.g., community colleges, charter schools, hospitals) and Employee Plans (EP) where the government entity is participating in a retirement plan or similar arrangement.

Workload selection will be monitored to ensure that key areas identified through environmental scanning, research, and other means are addressed, and that the actions being assigned represent the optimal approach to the identified issue. FSLG will continue to undertake compliance checks as a mechanism to provide broad-based compliance coverage, to identify customer needs, and to foster self-correction. In appropriate situations, compliance checks may be converted to examinations with the approval of the group manager.

Training

FSLG provides basic and advance training to its newly hired Specialists and Continued Professional Education to all Specialists. FSLG Specialists have consistently commented favorably on the training provided. For the Training Plan, see Appendix A.

Compliance Plan

FSLG examinations of books and records relating to the determination of a tax liability will generally address employment tax issues, Social Security Act Section 218 compliance issues, information return issues, FICA replacement plan issues, Abusive Tax Avoidance Transactions and other priority work.

FSLG generally conducts compliance checks on smaller entities (annual payroll less than \$10 million) to determine compliance with their employment tax and information return reporting obligations. Compliance checks do not include review of the books and records of the taxpayer and are designed to foster self-compliance. If the Specialist determines that the government entity is not in compliance, the case is converted into an examination or an advisory letter is issued to the government entity depending upon the extent of non-compliance.

FSLG will continue the two strategic initiatives started in FY2005: the Federal Agency Initiative and the Large Entity Initiative. For the Compliance Plan see Appendix B.

FSLG will participate on an Employment Tax National Research Program (NRP) project to develop data to help identify sources of the tax gap related to employment taxes. The tax gap research project on employment taxes was developed during FY2009, as part of a Servicewide effort. FSLG will examine 360 returns or 90 entities during 2010, with some increase in subsequent years during the three-year examination project. These audits are expected to begin in January 2010. Due to the potential impact of these cases, some of which could be large or Federal Agency cases, FSLG is limiting opening any additional compliance projects during FY2010.

In the last few years, numerous entities have contacted FSLG to resolve inadvertent errors in filing or payment compliance in prior years. In such instances, the issues have been resolved through closing agreements between the entity and FSLG. The number of voluntary closing agreements has increased each year. FSLG encourages government entities to regularly review their filing and payment compliance and, if inadvertent errors have occurred, to contact FSLG. The voluntary closing agreement requests are controlled and worked by CPM analysts. In FY2010, FSLG will implement a questionnaire created in cooperation with ACT that government entities may use to conduct self-checks. The questionnaire will be added to FSLG's website upon completion.

Research

FSLG will continue to work on perfecting the customer database. During FY2006, FSLG worked with the Census Bureau database of government entities to identify its customers and substantially increase the number of government entities listed on the IRS Business Master File. In FY2007, FSLG worked with the system owners to make systemic changes to insure FSLG customers remain coded properly and also to update the IRM procedures that were necessary related to these changes. In FY2008, FSLG updated employment codes of over 17,500 government entities. Additional updates were completed in FY2009. In FY2010, FSLG will continue to identify additional entities and change employment codes. For the Research Plan see Appendix C.

Performance Measures

The following performance indicators will be used in FY2010 for assessing Budget Activity Code 64, PAC EF:

Federal State & Local Governments	FY2010 Plan
Examinations Closed	1800
Compliance Checks Closed	855
Examination Timeliness	275
Examination Quality	84%

For FY2010, FSLG will focus on continuing to improve its compliance efforts through a balance between education, outreach and enforcement activities.

Appendix A

TRAINING

The following items are descriptions of FSLG training courses:

Course 10055: Continuing Professional Education – FSLG

This course covers continuing education to maintain and enhance employee professional skills. The class will be provided to all field Specialists and selected OPR staff.

Course RICS/CDA – Phase I

The current RICS system will be replaced by a new system. This training covers RICS functionality for using the new RICS/CDA system. CPM staff that classify FSLG work and/or develop the FSLG workplan and compliance projects will attend this class.

Course: TREES

New FSLG Specialists and CPM staff will attend this Work Center training course.

Course 4307: Medical Resident FICA Claims Training

This training will provide guidance to selected FSLG examination personnel in handling FICA refund claims and related issues with respect to medical residents.

Course 4321: Federal, State and Local Government Specialist- Ph I

This training will focus on providing initial FSLG tax law training for new FSLG employees, including basic employment tax training for FSLG Specialists. Training will be provided to new FSLG field Specialists, managers, and CPM staff.

Course 4323: Federal, State and Local Government Specialist- Ph II

This training will focus on providing additional FSLG tax law training for FSLG employees, including more complex employment tax training for FSLG Specialists. Training will be provided to new FSLG field specialists, managers, and CPM staff.

Course 4323: Federal, State and Local Government Specialist- Ph III

This is advanced phase training for FSLG field employees. Training will be provided to new FSLG field Specialists, managers, and CPM staff.

Course 3142: Basic Employment Tax Training

This training provides new FSLG Specialists with basic employment tax skills when FSLG Phase training is not available.

Course: On-the-Job Instruction Phase I

This course provides workshops and on-the-job experiences to new FSLG Specialists following FSLG Phase I to prepare them to do FSLG compliance checks.

Course: On-the-Job Instruction Phase II

This course provides workshops and on-the-job experiences to new FSLG Specialists following FSLG Phase II to prepare new FSLG Specialists to do FSLG examinations.

Course 15770: SGML Training (IRM Writing)

This course provides training to CPM staff members who write the IRM.

Course: Functional Leadership

This course provides training to frontline managers.

Course: Mandatory Topics

This training includes various annual mandatory briefings such as UNAX, Ethics, POSH, etc.

Course: Micro Purchase Card Training

This SkillSoft course provides employees training on using purchase cards. One staff member will take this course.

Course: Frontline Leadership Readiness Program

This course provides training to frontline managers.

Course: International Tax Seminar

This training provides information about international tax law.

Course: Annual Fraud Summit

This training provides information about Servicewide fraud policies and procedures. FSLG's Fraud Coordinator will attend this training.

Course: National Research Project

This training provides information about working NRP cases and the data capture instrument.

Appendix B

COMPLIANCE PLAN

I. INTRODUCTION

The FY2010 compliance plan continues to focus on areas where FSLG can most effectively apply its compliance resources to meet organizational goals.

Compliance activities include general examinations, examinations of refund claims, and compliance checks of entities for reporting compliance, non-filing conditions, and balance due accounts. In response to numerous Government Accountability Office (GAO), Treasury Inspector General for Tax Administration (TIGTA) and Office of Management and Budget (OMB) reports indicating widespread and longstanding Federal agency non-compliance, FSLG established during FY2005 a group dedicated exclusively to working Federal agencies.

II. CHALLENGES AND CONSIDERATIONS IN DEVELOPING THE COMPLIANCE PLAN

Determining the best use of compliance activities is a daunting challenge, made more so because of the lack of FSLG examination benchmarks and baselines.

In FY2006, FSLG began collecting examination results with the use of Case Selection Survey sheets that are required to be completed by the Specialists for all closed examinations and compliance checks. While FSLG began collecting data since January 1, 2005, the data was not collected in a manner conducive to analysis. During FY2007, FSLG completed modifications to the information database and has begun analyzing the data collected for use in developing market segment projects. Although in-depth analysis of the data was not yet available for extensive use in creating the FY2010 Compliance Plan, such analysis should be available at the beginning of FY2010 to help identify the most productive classification criteria to use in the return classification process during FY2010. The data may also provide compliance information that can be used in outreach activities.

The Compliance Plan is developed through a cooperative process involving input from field group managers, Specialists and the CPM staff. Field groups contribute to the plan by continuing to refer issues and information for consideration in the planning process. CPM uses the approved Compliance Plan and the supporting information to develop workload classification criteria for FSLG.

Because FSLG baseline data are currently insufficient to provide statistically valid data, FSLG must rely on currently available data in developing issues for audit consideration. These sources include:

- Anecdotal comments based on employee experience;
- State folders developed by Specialists;
- Outreach results;
- Filters developed by CPM;
- cursory review of compliance issues reported on closed compliance check and examination cases;
- Referrals;
- GAO Reports, and
- Top Payers with taxpayer identification number (TIN) mismatch reports.

Coordinated/Support Examinations with Other IRS Functions

FSLG continues to work with EP when issues arise with respect to retirement plans and also when EP discovers employment tax issues during its examinations. In addition, FSLG works with EO where the government entity is also an exempt organization. In addition, in FY2007, FSLG and LMSB (International) began coordination of common issues, such as appropriate classification and tax treatment of workers in Federal agency offices overseas where the workers are United States citizens or residents. This coordination will continue in FY2010.

FSLG receives referrals from, and provides referrals to, EP and EO via the Specialist Referral System program.

III. EXAMINATION PLAN

All compliance work will originate in or be approved by CPM prior to initiation of the cases. Compliance selections will include large, medium and small entities.

(a) STRATEGIC INITIATIVES

FSLG Large Entity Program

During FY2010, FSLG will increase the number of examinations of entities with annual payrolls in excess of \$40 million. This is a nationwide strategy - each group across the country will be responsible for working a number of large entity examinations. These are time intensive cases and will often require the assignment of a team of Specialists. Most of these examinations will be conducted as focused audits. The cases will be identified by CPM using RICS.

Based upon the results of the large entity examinations conducted in FY2006 through 2009, FSLG will continue to:

- refine large case selection criteria,
- commence 45 examinations of large government entities and complete at least 45,
- conduct focused examinations of large entities (the issues on which the Specialist will focus will be determined with the assistance of the group manager and will be based on the Case Selection Survey sheet provided by CPM),
- increase use of teams (two or more Specialists and CAS, if needed) to conduct audits on larger governments, and
- plan outreach activities based on results.

Uncertainty continues to hinder resolution of medical resident claims. This uncertainty precludes specific planning objectives for these claims. Most of the medical resident claims are filed by large entities.

Federal Agencies Program

During FY2010, examinations of Federal agencies and sub-agencies will remain a strategic initiative of FSLG. These present the largest and most complex cases. Examinations in this sector will be based initially on specific non-compliance issues identified from sources such as GAO reports, SS-8 determinations, outreach/assistance efforts, and other sources. As noted in GAO Report 04-74, Federal agencies continue to exhibit significant non-compliance with information returns and backup withholding requirements. FY2006 was the first full year for FSLG to conduct examinations of Federal agencies. The issues most prevalent in such examinations were: worker classification, relocation and settlement payments, foreign residents; information reporting, and fringe benefits. In other words, issues similar to those raised in state and local governments. In FY2010, FSLG will conduct additional Federal examinations using a team audit method. The Director, FSLG, will continue to approve all proposed Federal examinations prior to initiation. FSLG will commence examinations of 15 Federal agencies in FY2010.

Based upon the results of the Federal agency examinations conducted in FY2006 through 2008, FSLG will continue to:

- refine case selection criteria,
- evaluate the need for resources,
- commence 15 examinations of Federal agencies/sub agencies and complete at least 15,
- continue to refine processes for Federal agency examinations,
- conduct focused examinations (the issues on which the Specialist will focus will be determined with the assistance of the group manager and will be based on the Case Selection Survey sheet provided by CPM),
- increase use of teams to conduct audits on larger Federal agencies, and
- plan outreach activities.

For several years, FSLG, the CFO's office, and Collection have been discussing the issue of Federal agency delinquencies. In FY2007, FSLG, the CFO's office and SB/SE Collection began monthly status calls/meetings to discuss the roles and responsibilities of the three functions and the IRS policy for enforcing Federal Agency filing and paying compliance issues. This will continue in FY2010.

National Research Program (NRP) Project

In FY2010 through 2012, FSLG will devote a significant amount of its examination resources to the Employment Tax National Research Program (ETNRP). ETNRP is a three-year project designed to develop data to help identify sources of the tax gap related to employment taxes. The project was developed during FY2009 as part of an IRS-wide effort. FSLG has committed to examine 360 returns or 90 entities during FY2010. These audits are expected to begin in January 2010. The number of examinations conducted in FY2011 and 2012 is expected to increase based upon experience and available resources. Currently, FSLG projects increasing NRP cases in 2011 to 120 entities. Due to the potential impact of these cases, some of which are large agency cases, FSLG will limit other projects to small compliance projects in FY2010.

(b) GENERAL CASE WORK

States and State Agencies

These cases are potentially very large and complex, comparable to Federal entities. The challenge in this sector is to determine the number of filing entities in each state. State agencies and entities have been identified by the field and furnished to CPM. CPM will cross-reference this data with the BMF to determine the number of state entity filers. State level entities will then be identified for

examination through the field referral process, third-party information, compliance issues developed in outreach/assistance efforts, and regular CPM examination selection criteria.

Local Governments

These include all other entities. The complexity and size of these entities varies significantly. The local government sector includes the following major segments: counties, cities/municipalities (further stratified by population, wages or other criteria), school districts, local hospitals/medical facilities, library boards, and special purpose districts.

Information Reporting

Payments by FSLG customers represent a significant part of the national economy. Research indicates that when information returns are not issued, or incorrect TINs are used, significant income amounts are not reported on tax returns. A GAO review of Federal agencies found significant compliance issues involving information reporting and backup withholding. No similar study was done on non-Federal entities. FSLG requires that each examination and compliance check contain information reporting compliance determination. FSLG will work with governments to improve information reporting at all levels of government. Reporting compliance in the proper filing of Forms 1099, 1042, 1042-S, and W-2G will be addressed through field compliance actions, including compliance checks and examinations. A determination whether the government entity meets with its information reporting requirement is mandated in every examination and compliance check.

(c) SPECIFIC PROJECTS

International Tax Compliance Project

In FY2010, FSLG will begin development of an international compliance program. This program will include outreach activities as well as examinations of 25 employment tax returns related to international issues including Form 1042 audits of colleges/universities, Form 1042 nonfilers, organizations that have filed significant numbers of Forms 1042-S but have stopped filing Forms 1042-S, organizations not properly complying with employment taxes based upon visa or resident alien status, and compliance activities in the U.S. Possessions.

Colleges and Universities

FSLG is coordinating with TE/GE's Exempt Organization business unit on a compliance project for colleges and universities, which is focusing on unrelated business taxes, employment taxes and inurement/private benefit issues. This project involved sending a compliance check questionnaire to 400 randomly selected public and private colleges and universities. EO will conduct 34 examinations beginning FY 2010. FSLG will conduct employment tax examination of the public universities selected under this project.

Non-responses to Form Letter

In FY2009, FSLG started conducting compliance checks on 50 Federal entities that failed to respond to Letter 3939 requesting information related to failure to file Forms 1099. During FY2010, FSLG will continue to conduct these compliance checks.

Emerging Issue

Many Federal agencies hire workers via personal service contracts (PSC), which are currently treated by most Federal agencies as independent contractors. However, many of the workers are employees under common law rules. In FY2009, FSLG coordinated with TE/GE Counsel and Office of Personnel Management to develop consensus related to this issue. FLSG began to address worker classification noncompliance related to PSC during its FY2009 outreach activities. It will continue these outreach efforts in early FY2010. It will begin to conduct compliance checks during FY2010 to specifically address whether the agencies have PSC language that directs how the workers are to be treated for employment tax purposes, and their understanding of and plans to comply with the issue. In FY2011, FSLG will initiate examinations to enforce compliance.

GECU

FSLG will coordinate with the Government Entities Compliance Unit (GECU) on various projects to address potential areas of non-compliance by small government entities, issues where soft-notices can improve compliance, etc. For example, FSLG will submit a project related to potential excise tax non-compliance by government entities that engage in "pull-tab bingo." It will coordinate with GECU to review responses to a survey sent by FSLG to various government entities in FY2007 requesting additional information to determine whether the entity should have an employment code of G, T or F. Approximately 10,000 responses still need to be reviewed (see Research Plan).

(d) COMPLIANCE CHECKS

Compliance checks planned for FY2010 will primarily address nonfiler entities and Form 1099-MISC filing compliance issues and will generally encompass the entities with an annual payroll of less than \$10 Million. These types of compliance check cases may not directly translate into examination issues/adjustments; however, field groups will be encouraged to recognize situations where a significant examination issue arises from a compliance check and to re-establish the case appropriately. Data regarding issues found are being gathered for use in future compliance efforts. FSLG is currently planning on completing 940 compliance checks in FY2010, covering all of its market segments.

(e) NONFILERS

FSLG Specialists are encouraged to be mindful of nonfilers by identifying potential areas of non-filing. In the past, FSLG has addressed filing compliance through soft notices/self-correction, compliance checks and correspondence examinations. In FY2010, FSLG will continue to address filing compliance in all compliance contacts, will continue to identify regional pockets of non-filing by small governments that can be addressed primarily through “soft-notices” and self-correction, and will also conduct a specific project dealing with Forms 1099-MISC Nonfilers. In addition, CPM will continue to conduct research to identify government entities that are nonfilers for potential workload selection. It will coordinate various projects with GECU when contact by the GECU is the most effective manner to address nonfilers.

Appendix C

FY2010 FSLG RESEARCH PLAN

I. OVERVIEW OF RESEARCH PLAN

Purpose

The purpose of the FSLG Research Plan is to coordinate existing and future research efforts that FSLG is conducting to address identification of customers, customer characteristics, assessment of risk, allocation of resources, trends, issues and problem identification. The research plan is necessary to meet the goals and objectives of the TE/GE Strategic and Program Plan as well as those of the FSLG Work Plan. The research plan will also provide a basis for predicting taxpayer needs and compliance levels.

Information developed through research will allow FSLG to identify and analyze risk, educational gaps, and to develop trends and measurements. An ongoing research process is an essential component of FSLG's efforts to ensure compliance. In order to meet its obligations to its customers, FSLG will use techniques including focused taxpayer education, improved reporting, and early intervention through notices and phone calls, to address voluntary compliance.

The primary objectives of the research plan are to identify, quantify and monitor FSLG customers and their unique compliance issues. The major goals of the plan are as follows:

- ◆ To identify all government entity customers
- ◆ To identify trends, issues and problems of customers
- ◆ To determine compliance risk levels
- ◆ To identify workload for various compliance treatments

Scope

The scope of the research plan is being set at a level that can be achieved using existing resources without adversely impacting FSLG's major educational and compliance goals.

Background

When the research plan started in FY2005, the FSLG customer base comprised 85,382 government entities, not including potentially thousands of sub-units that provide employment tax and information return reporting information for consolidation to a particular entity. Of those, 73,069 customers filed at least one Form 941 in the tax year 2005. There were 69,010 FSLG customers who filed Form 941, and 3734 who filed an annual Form 944 for the tax year 2006.

Government entities employ approximately 20% of the workers in the US, approximately 23 million employees. They pay more than \$775 billion annually in wages and employment taxes in excess of \$200 billion. The majority of these organizations are local government entities such as cities, counties, towns, school districts, etc. The governments also purchase goods and services of more than \$2.9 trillion and have an economic impact of representing 19% of the United States gross domestic product.

II. IDENTIFICATION OF CUSTOMERS

Objective

To identify the universe of FSLG customers

Background

FSLG has now identified, through the IRS Business Master File (BMF), over 105,000 employer identification numbers that belong to government entities. However, this figure does not include all of the sub-units that report employment tax and information return reporting information to the entity that files a consolidated Form 941 or has one Employer Identification Number. There are many larger government entities that contain multiple operating units that are counted as a single entity while filing multiple returns or, conversely, entities filing a single return for multiple entities. These units report millions of dollars of wages and vendor/contractor payments through the “filing” entity. For example, the U.S. Department of Agriculture National Finance Center processes payroll for a significant number of Federal agencies and files one return. This significantly understates the number of government entities in the FSLG customer base.

FSLG identified its initial customer base using the Government Integrated Directory (GID) based on the Census of Governments conducted by the U.S. Bureau of the Census every five years. FSLG uses IRS BMF records with employment codes F (Federal agencies), G (state and local governments), T (state or local governments with Section 218 Agreements with the Social Security Administration), and A (government entity for government fiscal agents) to identify return filings of its identified customer base.

Although the initial data contained some significant flaws, for example the Census database and the Public Employer FICA Compliance Initiative (218 Initiative) do not include EINs (Employer Identification Numbers), most government entities have been captured in our database.

The process of assigning EINs to new entities now identifies government entities that need to be coded with employment code F, G, and T. FLSG taxpayers, however, are generally not assigned an employment code of T unless the taxpayer correctly indicates on the Form SS-4 that they have a 218 agreement. There is one major component that needs to be corrected and that is to establish a means to identify sub-units of governments that are part of a larger organization.

Available Data Sources

- Business Masterfile Entity records
- Bureau of Census database for 2007 Census of Governments
- Public Employer FICA Compliance Initiative (218 Initiative) data
- Information Returns data from RICS
- TE/GE Entity information from RICS
- Various internet sites listing governmental organization data

Resource Requirements

- Assistance of LMSB Computer Audit Specialist
- Assistance from the GECU at Ogden Campus with staff time (FTE) to update BMF and contact taxpayers
- Assistance of TE/GE research office and GE research analyst in developing criteria and ensuring statistical accuracy of the program.
- Appropriate computer systems support, including software, training and equipment.
- Adequate staff time (FTE) to develop this aspect of the program.
- Assistance from MITS in updating the FSLG customers with the proper employment codes.
- Assistance from MITS in searching payer master file data to identify nonfilers

Milestones

The principal task is to compare and reconcile various sources to identify all government entities or significant sub-units for inclusion in FSLG's customer base. Many major milestones have been completed. However, the identification of FSLG customers is an ongoing process due to new entities, mergers, and dissolutions. The major milestones completed and to be completed are:

- Match data from Census' government data to BMF data to develop unmatched entity database to identify needed BMF corrections - completed September 30, 2006.
- Send survey letters/request for entity information to taxpayers on the unmatched database (25,167 entities) - completed January 29, 2007.
- Reconcile unmatched entities to determine proper classification and contact those taxpayers where additional information is necessary to determine whether entity should have an employment code of G, T or F. Approximately 10,000 survey letters responses still need to be reviewed. GECU will begin working on this in FY2010.
- Work with BMF analysts and programmers to correct systemic problems in entering FSLG employment codes. A work request to allow BMF to accept an employment code with no filing requirements- completed July, 2007.
- Request that all relevant IRM procedures be revised to ensure FSLG employment codes are assigned even if there are no filing requirements – completed July, 2007.
- Identify potential nonfilers – work request completed to request a list of taxpayers that exist in the Payer Master File but not in the Business Master File. This work request is now part of GE's annual work request.
- Identify and correct errors in employment codes – Submitted work request that will keep FSLG employment codes in master file indefinitely. This work request will allow unique filing requirement codes, such as Puerto Rico, Virgin Islands, Guam and American Samoa filers to be coded as FSLG customers - completed January, 2008.
- Identify significant sub-units through on-line research and other appropriate means – Initiated with the survey letter project at the Ogden Campus and with the review and research of Section 218 entities and the RICS database. GECU will work on this - ongoing.
- Identify and implement procedures to keep the database of customer's current- Work request submitted to update entities that have been identified as FSLG customers - completed April, 2008.
- Work request submitted to have the command code NAMEE in a spreadsheet format so that entities with no identification number can be reviewed more expeditiously. The 218 list of entities with no EIN will be processed and the results will be sent to GECU for review of potential FSLG entities not noted with an employment code T. WR completed June, 2009. Estimated completion date FY2011.

III. IDENTIFICATION OF TRENDS, ISSUES AND PROBLEMS (TIP)

Objective

Identify customer trends, issues and problems to support TE/GE Strategic Program and Plan and the FSLG Workplan.

Background

There is an ongoing need to develop TIPs for planning purposes. FSLG has been gathering information from various sources for this purpose. Some examples are customer outreach data, issues identified during compliance checks and examinations, internal/external information items, etc. Including these sources in the research plan will allow FSLG to formalize the process of securing the information, analyzing the data, and taking actions to address the TIPs as part of the planning process.

Available Data Sources

- FSLG outreach database
- Examination/Compliance Check issue tracking data
- Internal/external information reports
- Internet/media reports
- Payer Master File Data
- La Hacienda, Puerto Rico
- EO, SBSE

Milestones

- Centralization of data
- Analysis of current data
- Identification of TIPs
- Identification of compliance issues suitable for targeted treatments

IV. ASSESSMENT OF RISK OF NON COMPLIANCE

Objective

To determine the risk of non-compliance with employment tax and information return reporting statutes. This also involves identifying major compliance risks.

Background

The risk of non-compliance is primarily based on limited compliance activities, anecdotal information and various external reports/data. FSLG believes that government entities generally want to comply. There is also an assumption that the smaller local governments are at greater risk due to lack of understanding of the Federal tax law as well as high rates of employee turnover. The larger entities, including Federal and state agencies, are at risk due to their larger numbers of employees, potential for error and impact on the trust funds due to their size.

Available Data Sources

- Bureau of Census database for 2007 Census of Governments
- Historical Forms 941 data from master file
- Forms 941 data for CY2001 forward on RICS
- Public Employer FICA Compliance Initiative (Section 218)
- Information returns data from RICS
- Balance due data based on employment codes
- FSLG customer contact data
- Additional data sources to be made accessible to RICS
- Potential development of a Service wide employment tax classification database currently under development in SB/SE

Resource Requirements

- Assistance of TE/GE research office in developing criteria and ensuring statistical accuracy of the program
- Appropriate computer systems support, including software, training and equipment
- Adequate staff time (FTE) to develop this aspect of the program
- Formal training on use of software

Milestones

- Develop an FSLG risk analysis methodology in conjunction with TE/GE research
- Refine definitions of non-compliance for FSLG entities in cooperation with TE/GE research office
- Identify and obtain additional data sources
- Maintain the developed risk analysis system to insure continued viability